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Docket Management Facility
U.S. Department of Transportation
Room PL-401
400 Seventh Street, SW
Washington, DC 20590-0001

Re: Docket Nos. USCG-2003-14472, MARAD-2003-15171;
Vessel Documentation: Lease Financing for Vessels
Engaged in the Coastwise Trade

Ladies and Gentlemen:

Thank you for the opportunity to comment on proposed rulemakings by the United States Coast Guard (USCG) and the Maritime Administration (MARAD) related to lease financing by non-Section 2 U.S. citizens of vessels engaged in the coastwise trade. The proposed rulemakings are outgrowths of a final rulemaking (USCG-2001-8825) published by the USCG on February 4, 2004 (69 F.R. 5390). That final rulemaking resolved many contentious issues about lease financing arrangements, including the appropriate levels to apply the aggregate revenues test and vessel operation/management standard, the meaning of lease financing, other appropriate definitions, and extension to undocumented barges. The USCG purported to balance permitting non-Section 2 citizen lease vessel financings for coastwise trading vessels and maintaining the Jones Act. It imposed a number of new requirements to strengthen maintenance of the Jones Act. No opinion is expressed about the merits of those judgments. These comments address the possible application of those new requirements on transactions that the USCG has already permitted.

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I. USCG Proposed Rulemaking USCG-2003-14472

The USCG proposes to amend its final rule in Docket USCG 2001-8825 to limit its grandfathering of existing transactions to three years from February 4, 2004. It also proposes to prohibit or restrict subcharters of the lease financed vessels to a member of the group of which the vessel owner is a member, presumably immediately as to future transactions and presumably after three years to grandfathered transactions, although that point needs to be clarified. It is appropriately considering exempting from such prohibition or restriction, operations involving proprietary carriage or operations for which the vessel will earn revenue for the demise charterer if the demise charterer would retain all aspects of control of the operation of the vessel, other than that which is directly involved in generating revenue. Finally, the USCG is asking whether an independent third party with expertise in vessel chartering should review and approve applications for endorsements under the lease financing documentation provisions. Three comments are made to these proposals: (1) grandfather provisions are essential, (2) the proposed three-year grandfather provisions are arbitrary, and (3) no limitation can appropriately be imposed on the duration of the grandfather provisions.

A. Grandfather Provisions Are Essential. Grandfather provisions are necessary for the USCG's final rulemaking which was promulgated pursuant to a statutory scheme that did not indicate expressly an intention to allow promulgation of retroactive rules, and especially for previously approved lease financing transactions that dutifully complied with then existing clear USCG requirements. See Bowen v. Georgetown Univ. Hosp., 488 U.S. 204 (1988). The USCG recognized at least the underlining equities and is commended for including appropriate grandfather provisions in its final rulemaking. (46 CFR 67.20(b), (c), (d) and (e)).

B. Proposed Three-Years Grandfather Provisions Are Arbitrary. The explanations provided for the measure of three years proposed were: (1) "to bring these vessels and barges under the regulations within a reasonable time, yet to be responsive to the economic interests of those who have made investments relying on the Coast Guard's initial interpretation of the lease-financing structure....", (2) "a reasonable amount of time to provide owners with a sufficient time to plan and effectuate whatever restructuring is necessary to comply with the regulations," and (3) "Congress specified, in the lease-financing statute, a term of three years . . . as the minimum duration of a 'long-term' demise charter." The relevance of the last factor is a mystery. Putting aside, for the moment, why any limitation should be imposed on grandfathering provisions, a "reasonable" time would have to take into account, among other things, how extensive are the new requirements, how easily it would be to accommodate those new changes and the burden imposed on the reliant vessel owner. Three years is by no means related to the length of any possible subcharters and financing pertaining to the already approved lease financing transactions, except by the most fortuitous law of chance. Financing and subcharter periods are fixed by economic considerations and it is understood generally extend more than three years. Further, the new requirements greatly extend beyond the

previous requirements. For example, the inclusion of "affiliates" in the group, defined as a "person that is less than 50 percent owned or controlled by another person" is extraordinary. Theoretically, if any member of the group owns one share of common stock in a major shipping company, the revenue of that shipping company would have to be incorporated in determining whether the aggregate revenue test were met. Under that standard, unless further clarified by the USCG, it would be extremely burdensome for any conscientious entity of any significant magnitude to ascertain what companies are "affiliates." Aside from identifying affiliates, additional adjustment to the new requirements would require significant time and expense. Given the mass of documentation that surrounds any major (or even minor) vessel financing and chartering, the legal, accounting, tax and other costs incurred are substantial whether for adjustment of the existing arrangements or for termination and entry into new arrangements. Finally, three years from February 4, 2004 is not an adequate "grandfather" time because it is not possible to know how to change the structure satisfactorily. The USCG has yet to decide whether it will prohibit subcharters back to any group member or restrict said subcharters or to impose some other requirement. Any new requirement would have to be published and evaluated.

C. No Limitation on Grandfather Provisions Can Appropriately Be Imposed. The case law on retroactive rulemaking focuses on whether certain rules may be applied retroactively at all. E.g., Bowen, supra; Landgraf v. USI Film Products, 511 U.S. 244 (1994); and Rivers v. Roadway Express, Inc., 511 U.S. 298 (1994). The USCG appears to have invented a new permutation of "somewhat retroactive" or limited duration retroactive rulemaking. The legal foundation for this invention is unstated and is unknown.

Even assuming that the USCG could graft such a new standard on to existing law, the underlining reasonableness factor inherent in its approach would not logically result in application to the pre-existing lease financing transactions approved by the USCG. As already discussed, the existing USCG-approved lease financed transactions relied on governmental approvals and modifying them to comply with the greatly expanded final requirements will be burdensome. In many cases entities expended considerable sums to structure their transactions to meet pre-existing USCG requirements and incurred, and are incurring, substantial on-going economic risks in so structuring their transactions. The USCG mistakingly estimates that the economic impact on the grandfathered entities of ending the grandfather status in three years will be "minimal." The faulty reasoning seems to be that with three years of time to adjust, the financing impact will subside. However, the economic impact is adverse no matter how many years are involved. Perhaps, too, the USCG reasoning is affected by the limited number of entities (87) that have had their coastwise endorsements approved under the lease financing option and fewer (30) that are said to have engaged in a charter back to the vessel owner or related entity (may exclude undocumented barges). However, the fewer the number of entities affected, the less persuasive reasoning there is for not extending unlimited grandfather coverage so long as those transactions have not substantially changed. It is likely that

over the course of time many of those transactions will substantially change, and indeed it is understood that at least one major grandfathered entity has so changed.

There are no convincing countervailing considerations. At the oral hearing on the proposed rulemakings on April 2, 2004, certain Jones Act carriers expressed support for the three-year limit on grandfather provisions, presumably as an additional measure of protecting the Jones Act. However, the USCG has struggled to implement the lease-financed provisions as it understood Congress intended implementation. It has issued final rules and they weigh heavily in favor of protection of the Jones Act carriers. Imposing an arbitrary, short-term limitation on the grandfather provisions would eliminate the weighing undertaken by USCG and would unfairly, unjustifiably, and unreasonably penalize entities who relied on USCG actions, including necessarily other Jones Act carriers.

II. MARAD Proposed Rulemaking MARAD-2003-15171

A final comment pertains to MARAD's proposed change to its regulation (46 CFR Part 221.13). Under those regulations MARAD has given general approval under section 9 of the Shipping Act, 1916, as amended, for time charters of vessels or interests in vessels to persons not U.S. citizens as defined in Section 2 of the Shipping Act, 1916, as amended. MARAD proposes to revoke that approval in the circumstances of transfers of a lease-financed vessel engaged in coastwise trading back to the non-section 2 citizen-owner, the parent of that owner, a subsidiary or affiliate of that parent, or an officer, director, or shareholder of one of them. This proposal indisputably arises from the USCG's final lease financing rulemaking. MARAD does not include a grandfather provision for its revocation and is silent on whether it would entertain such a provision.

For all the reasons discussed in connection with the proposed USCG rulemaking, MARAD should coordinate its coverage with the coverage of the final USCG rulemaking in USCG-2003-14472, and include a grandfather provision for transactions for which USCG provides grandfather waivers. If MARAD fails to so act, the USCG grandfather provisions would be effectively nullified since a grandfather transaction under the USCG rulemaking would, unless exempted, be subject to MARAD's section 9 review and likely disallowance or restructure.

Thank you for the opportunity to comment.

Sincerely,

ROBERT J. PATTON, JR.
President